

Equity Markets : Current Environment and Outlook

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Current Environment

- Equity markets across the globe remained weak, with the MSCI World Index falling by 1.85%
- Indian markets underperformed the global trend, falling 7.18% in the month of October
- Commodity prices more than recouped the losses of the previous month with the benchmark CRB Reuters Jefferies total return index rising 7%
- In India, FMCG was the best performing sector followed by the Healthcare. Realty and IT sector delivered the worst return for the month
- FII inflows have remained positive on a YTD basis at Rs.512bn for CY09 after a Rs.91bn inflow in October
- In October, cash trading volumes (number of shares) fell 15% MoM, while the average open interest jumped by 11% MoM to a record high. Trading volumes (value) remained rose 1% MoM and are 36% below the October 2007 peak

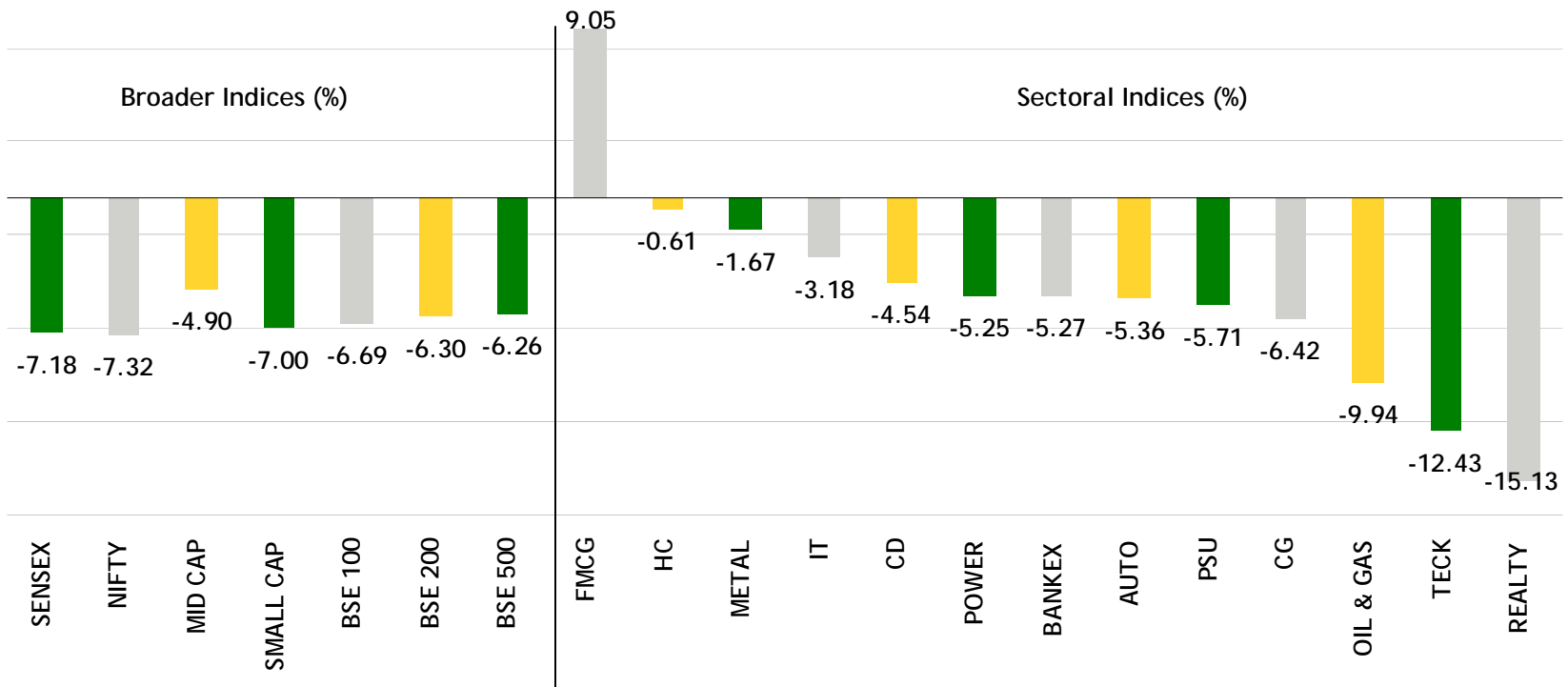
Global Equities

Index	Country	Closing Price*	1 Month Return (%)	YTD Return (%)	Category
SSE Composite Index	China	2995.85	7.79%	64.53%	EM - Asia
BSE Sensex	India	15896.28	-7.18%	64.77%	EM - Asia
Kospi	South Korea	1580.69	-5.53%	40.57%	EM - Asia
Taiwan Weighted	Taiwan	7340.08	-2.25%	59.87%	EM - Asia
Thailand SET 50 Index	Thailand	483.67	-5.50%	54.14%	EM - Asia
Jakarta Composite Index	Indonesia	2367.70	-4.05%	74.69%	EM - Asia
KLSE	Malaysia	1243.23	3.42%	41.80%	EM - Asia
Ibovespa Sao Paulo Index	Brazil	61545.50	0.04%	63.90%	EM
Mexico IPC	Mexico	28646.03	-2.01%	28.00%	EM
Russian RTS Index	Russia	1348.54	7.49%	113.41%	EM
Philippine PSEi	Philippines	2908.50	3.84%	56.19%	EM
Merval Buenos Aires Index	Argentina	2115.76	1.96%	95.97%	EM
HangSeng	Hong Kong	21752.87	3.81%	51.19%	Developed - Asia
Nikkei	Japan	10034.74	-0.97%	13.26%	Developed - Asia
Strait Times	Singapore	2651.13	-0.80%	50.50%	Developed - Asia
Dow Jones	USA	9712.73	0.00%	10.67%	Developed
CAC 40 Index	France	3607.69	-4.95%	12.11%	Developed
All Ordinaries Index	Australia	4646.90	-1.95%	26.99%	Developed
DAX Index	Germany	5414.96	-4.58%	15.09%	Developed
Swiss Market Index	Switzerland	6285.76	-0.59%	13.57%	Developed
FTSE 100	UK	5044.55	-1.74%	13.77%	Developed
MSCI World Index	--	1106.17	-1.85%	20.21%	--

* as on 30th October 09. Source : Bloomberg
EM – emerging markets, Developed – developed markets.



India : Sector performances



- The markets fell by 7.18% over the previous month
- FMCG was the best performing sector followed by the Healthcare sector
- Realty and IT sector delivered the worst return for the month

*Source: BSE,NSE. one month performance as on 30th October 09.



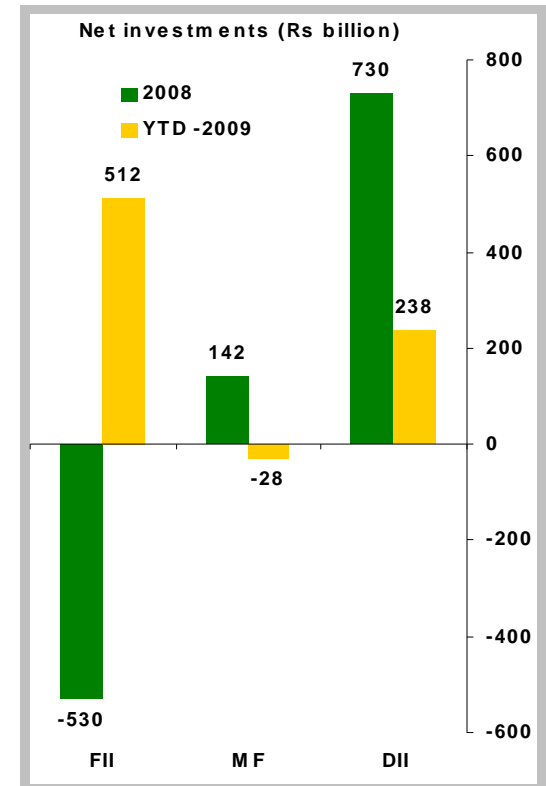
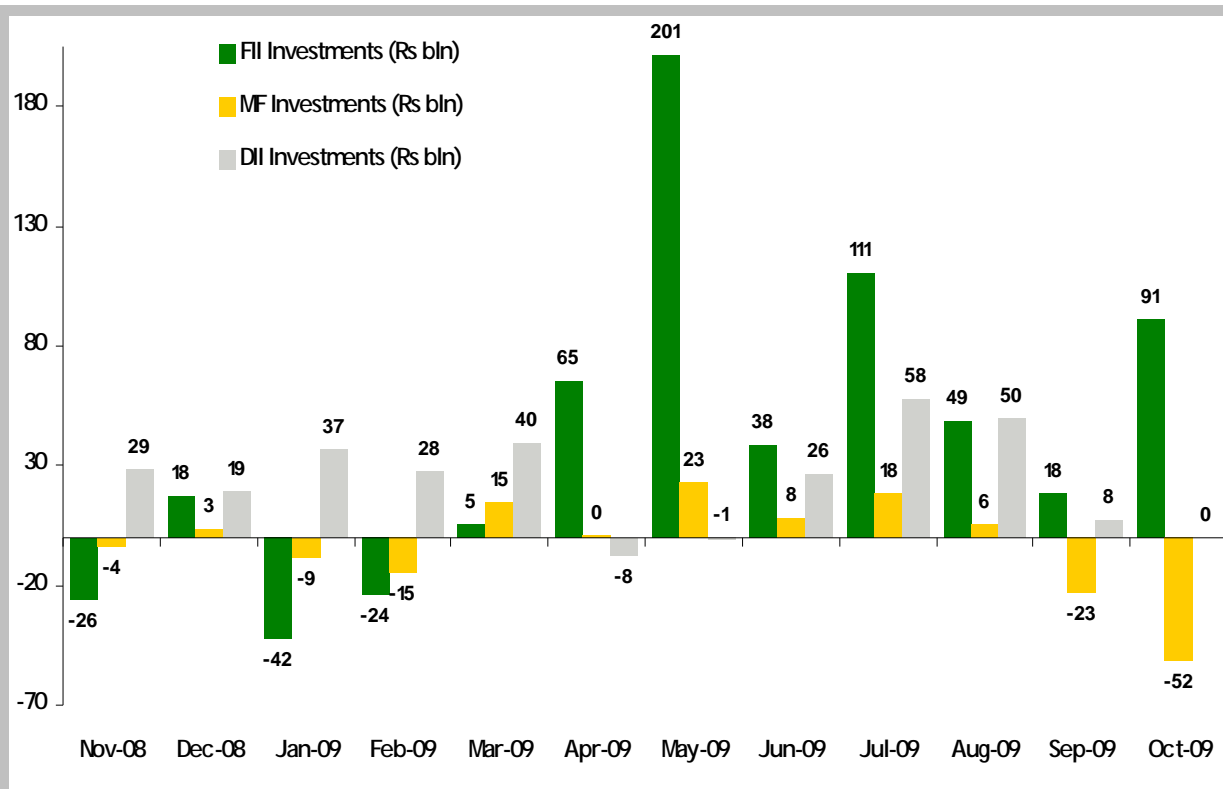
Top Gainers / Losers - Nifty

Top Gainers for the month			
Gainers	52 week H/L	Last Price#	% Gain*
ITC	266.5 / 151	254.8	9.33
Jindal Steel	738 / 106.04	641.5	9.28
Hind. Unilever	306.7 / 209.4	283.5	7.96
Punjab Natl.Bank	898 / 286	853.15	6.96
M & M	981.4 / 235	921.95	4.39
Top Losers for the month			
Losers	52 week H/L	Last Price#	% Loss*
Rel. Comm.	362 / 131.1	175.85	-43.16
Idea Cellular	91.8 / 37.1	52.05	-30.83
Bharti Airtel	518 / 270.55	292.85	-30.07
Suzlon Energy	145.7 / 33.05	66.85	-27.02
Unitech	116.65 / 21.65	82.25	-23.42

closing price as on 30th October 09.* one month performance as on 30th October 09.
Source: cmie prowest



FII & DII Inflows:

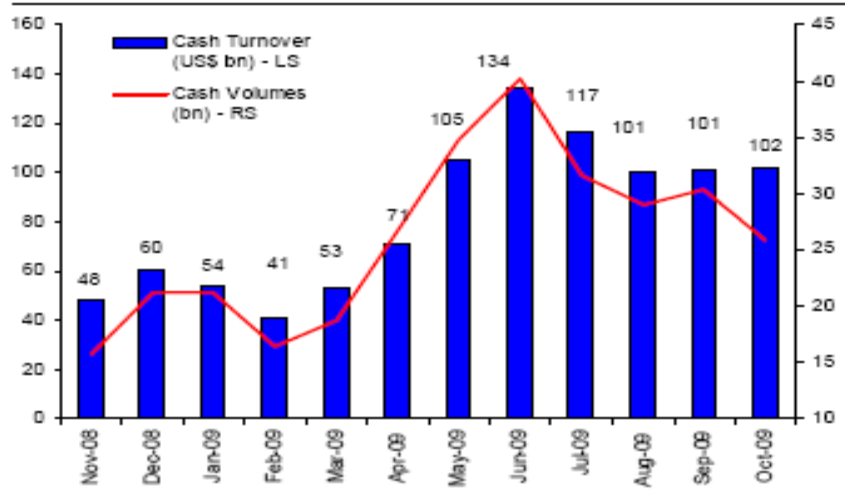


- FII inflows have remained positive on a YTD basis at Rs.512bn for CY09 after a Rs.91bn inflow in October
- DIIs did not contribute any incremental inflows. MFs, however, were net sellers to the tune of Rs.52bn



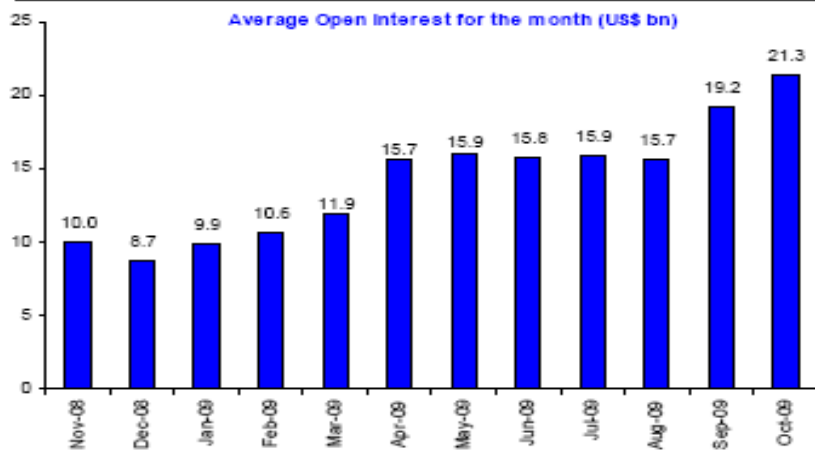
Market Activity

Cash Trading: Turnover and Volumes



Source: BSE, NSE, Morgan Stanley Research

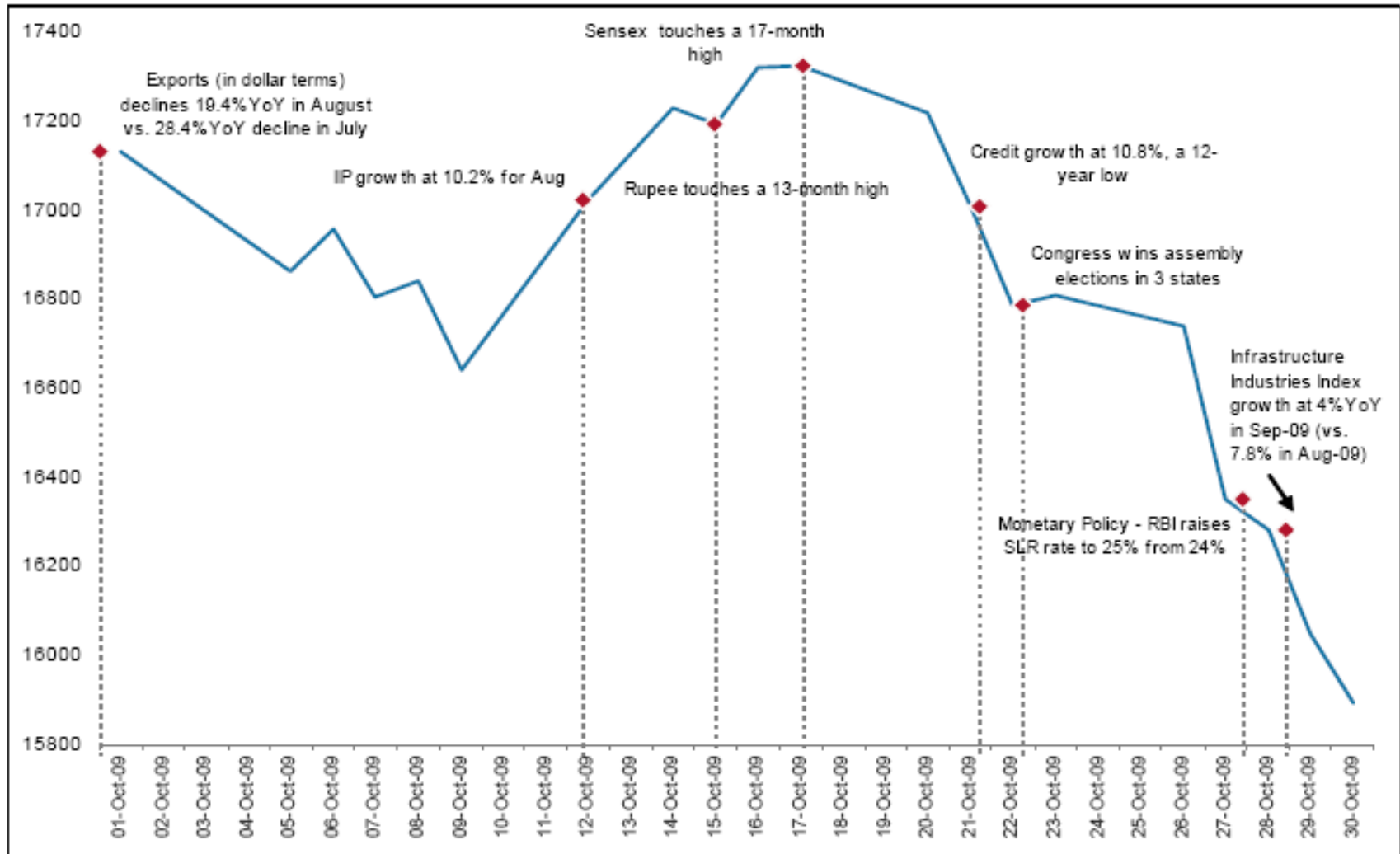
Average Open Interest for the Month



Source: Bloomberg, Morgan Stanley Research

- In October, cash trading volumes (number of shares) fell sharply, down 15% MoM and remains 36% below the Jun-09 peak
- Trading volumes (value) rose marginally by 1% MoM and are 36% below their October 2007 peak
- At the end of October, average open interest rose sharply, up 11%, to its highest level since Jan-08

October09 events timeline



Source: Bloomberg, Economic Times, Business Standard, Morgan Stanley Research

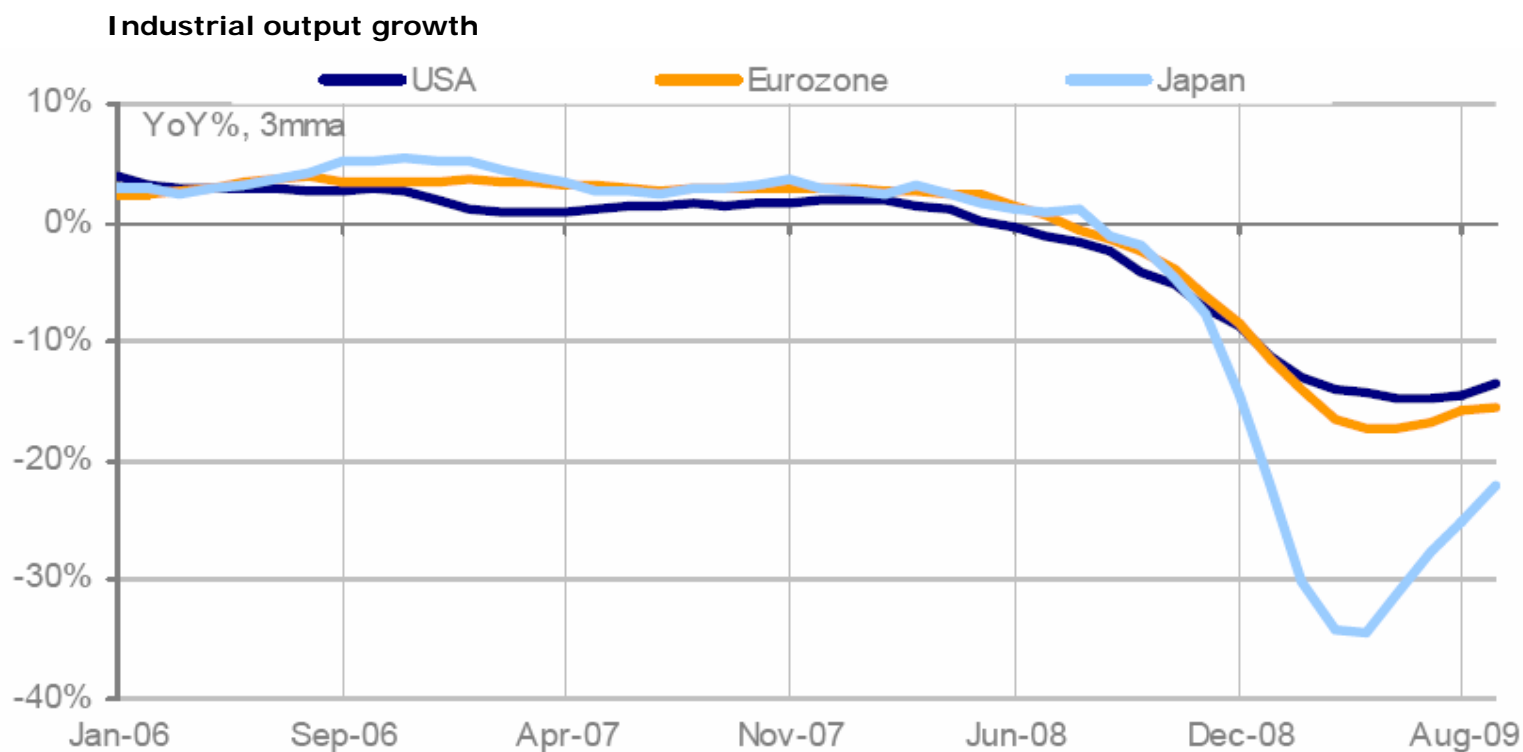


Religare MF: Equity Market Outlook and Opportunities

Equity Market Outlook

- Industrial output in developed economies continues to show an up-tick
- However, personal income has continued to decline due to rising unemployment in key economies of US, UK and Japan
- Bond futures market indicates an end to the current historic low interest rate regime
- Emerging markets like India have witnessed significant inflows from foreign retail investors courtesy ETFs. ETF inflows accounted for about 16.1% of total FII inflows into India in the last one year amounting to about US\$2.2 bn (source: Credit Suisse)
- Higher liquidity has resulted in short term (91 day) yields declining but the longer term yields have increased. The gap between 91-day yield and 10 year govt. paper has increased to around 325 basis points
- Though the RBI has kept the key policy rates unchanged, it has clearly hinted at a beginning of a reversal in policy stance
- Q2FY10 Sensex free float PAT grew 5% on a YoY basis. The growth is better than a 1% decline expected by market. However, FY10 and FY11 consensus Sensex EPS estimate saw a downgrade of about 0.8% this week
- Nifty is currently trading at 19.81x its trailing earnings, higher than the ten year average of 17.8x, mirroring a global surge in valuations with the MSCI Emerging Market Index also trading at approximately 21.36x trailing earnings

Global growth appears to be returning...

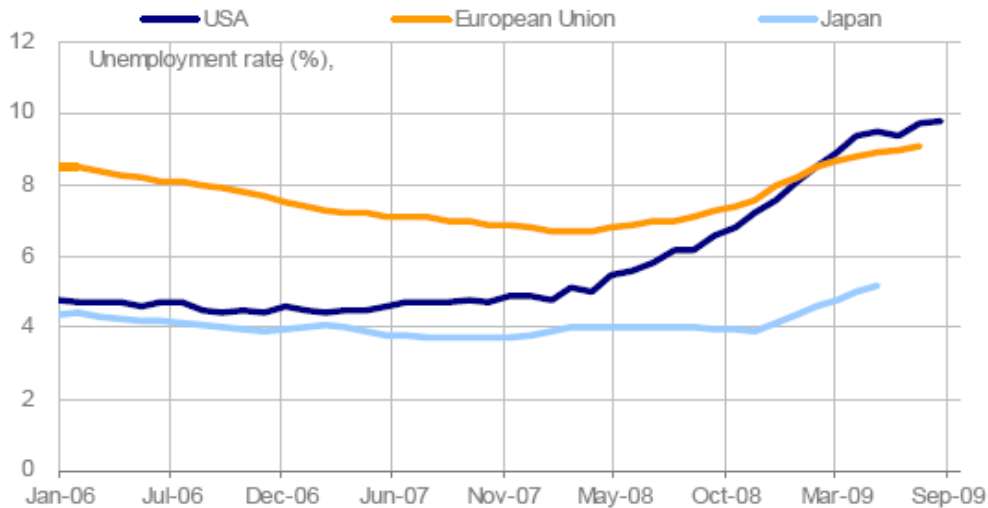


- Industrial output in key developed economies continued to report an up-tick
- Industrial output in Japan has rebounded sharply (post a similar sharp fall), while that of USA and Eurozone has started a gradual ascent

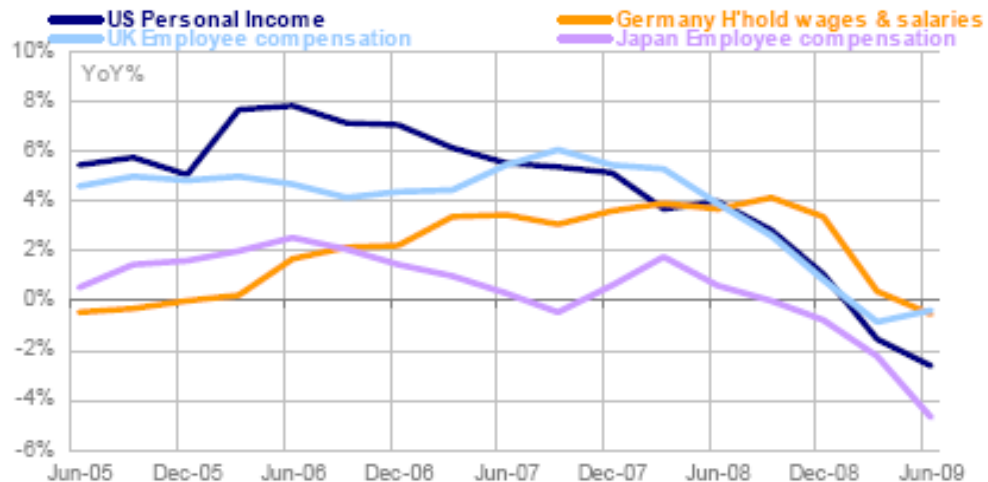


... though anchors of sustainability are absent

Unemployment Rate (%)



Personal Income Growth (%)

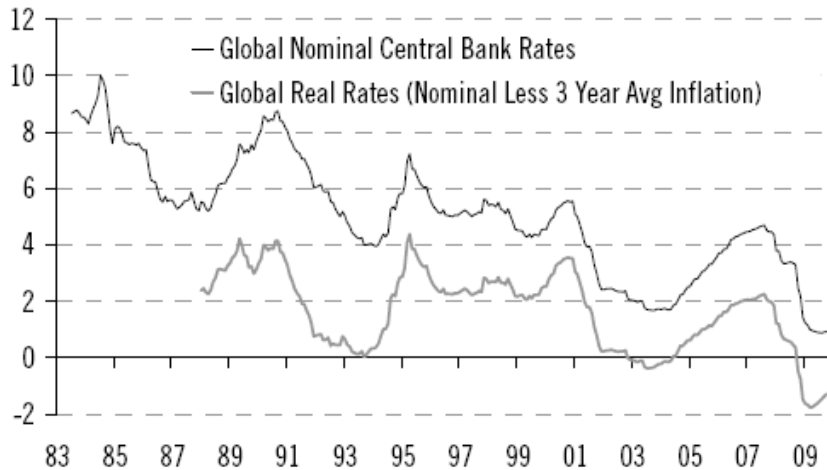


- The pillar of any economic activity is the consumer demand, which in turn is dependent on personal income
- The unemployment rate continues to rise in the developed markets of USA, Eurozone and Japan
- Rising unemployment has resulted in a continued decline in personal income in US, UK and Japan
- Such declines in personal income raises doubts regarding the outlook for consumer demand

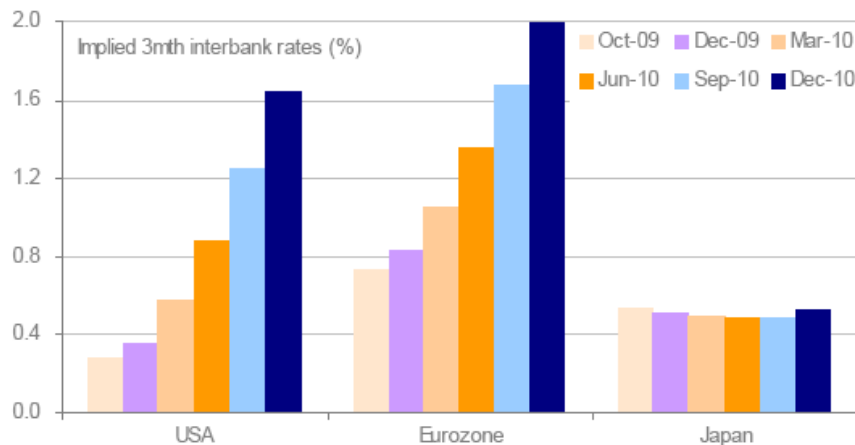


Rate hikes seem imminent

Global Nominal And Real Short Rates



Bond Futures - Implied Rates



- Economic stimulus given by global central banks has resulted in excess liquidity and low interest rates
- Low nominal interest rates have resulted in negative real interest rates
- This historic low interest rate regime is expected to be over soon, as is indicated by the bond rate futures market
- The bond futures market expects about 100 bps increase in 3 month inter-bank rates in USA and Eurozone in the next one year

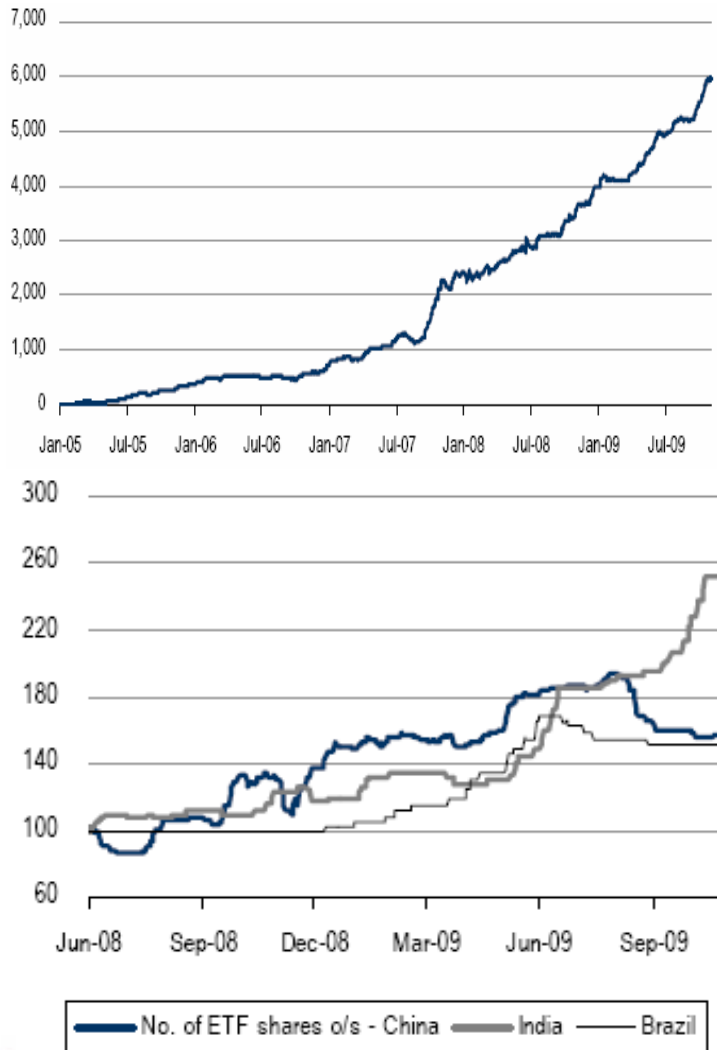


Sources: Factset, CIRA

Source: Bloomberg, IIFL Research. Rates implied from Euribor and Euro\$ forward contracts...

Indian markets being driven by liquidity

ETF 's flow into India - cumulative (USD mn)

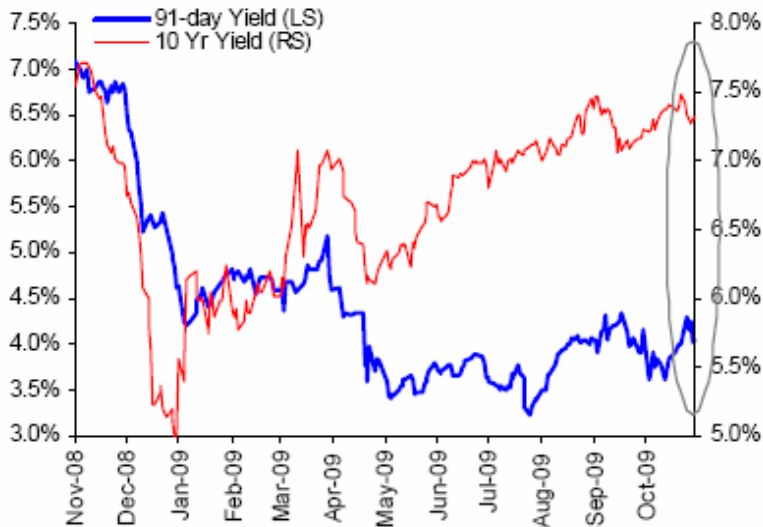


- ETF (Exchange Traded Funds) are funds that invest in a basket of shares and such funds can be bought or sold in a market like any other security
- ETFs have effectively allowed markets like India, China or Brazil to be traded like stocks for foreign retail investors
- The appeal of growth markets like India is so high that its ETFs, along with those of many other emerging markets, are the hottest stocks on the US bourses as is indicated by a steady increase in shares outstanding (units of a fund) of the ETFs
- Even within the three hot markets of China, India and Brazil, Indian ETFs demand appears to be the strongest, leading us to believe that the maximum retail interest is in India
- ETF inflows, according to Credit Suisse estimates, accounted for about 16.1% of total FII inflows into India in the last one year amounting to about US\$2.2 bn



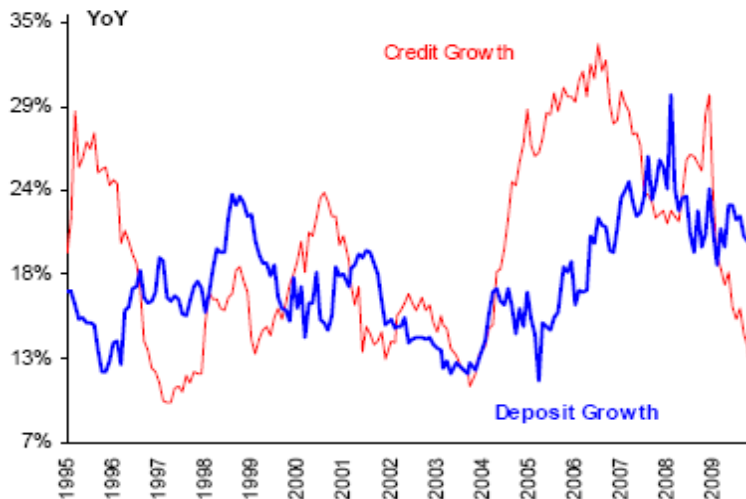
Excess liquidity impact on short term rates

10-year and 91-day Yield (%)



- Higher liquidity has resulted in short term (91 day) yields declining, while the longer term yields have increased
- The gap between 91-day yield and 10 year govt. paper has increased to around 325 basis points

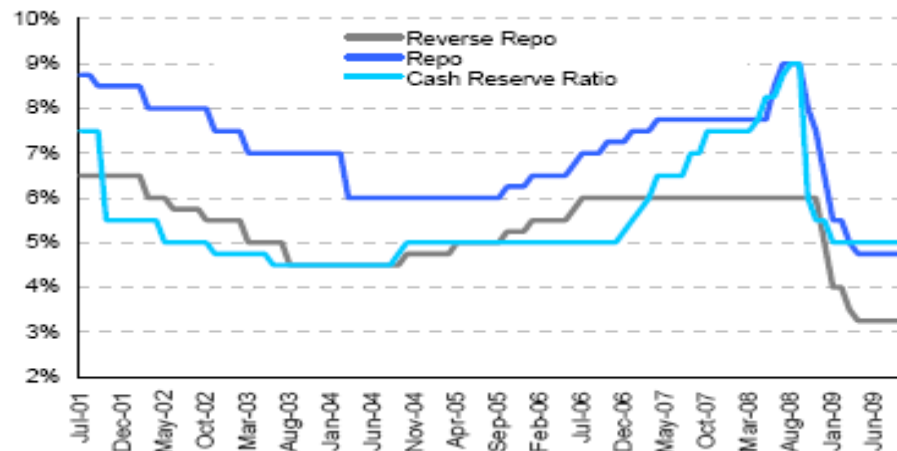
Credit and Deposit Growth (%)



- The demand for credit has not picked up yet, indicating that the industrial recovery seen till date has not yet resulted in increased demand for funds, either for working capital or for fresh capital expenditure



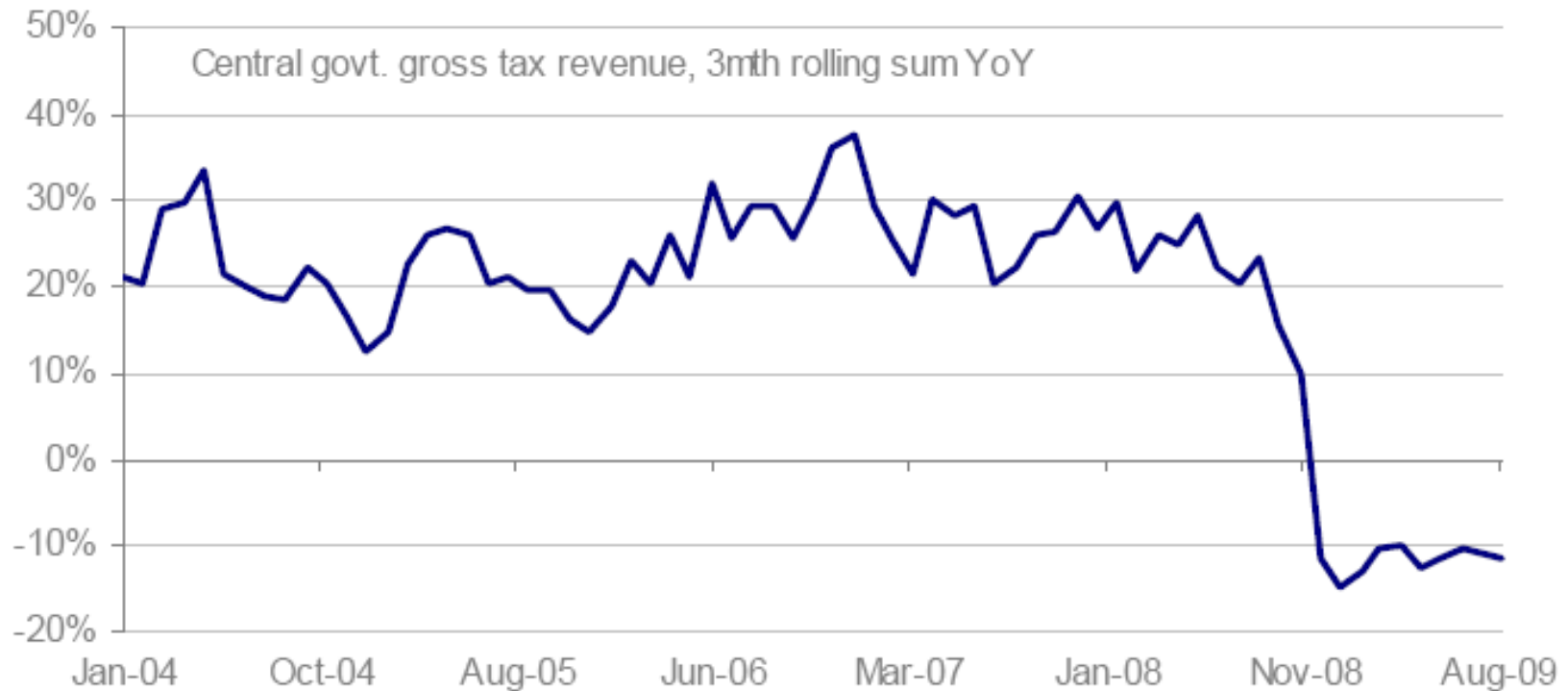
Monetary Policy - First Step Toward "Exit"



- **No change in policy rates:** The Reserve Bank of India, in its quarterly monetary policy review, decided to leave policy rates unchanged as per market expectations. However, the central bank also gave a clear indication that a monetary policy reversal is beginning
- **Partial reversal in liquidity support measures:** The monetary policy statement mentioned that the RBI is initiating the first step toward "exit" by discontinuing several unconventional liquidity support measures that were taken immediately post the unfolding of the credit crisis last year. The liquidity available through these measures was about US\$19bn
- **Prudential norms tightened:** The RBI tightened provisioning norms for loans to the commercial real estate sector classified as standard assets. The RBI now requires that banks should maintain a loan loss coverage ratio of 70% by September 2010. Earlier there were no specific loss coverage requirements for banks, and as a result the coverage rate varied between 30% and 90% across various banks



'Exit' pressure also from the fiscal side

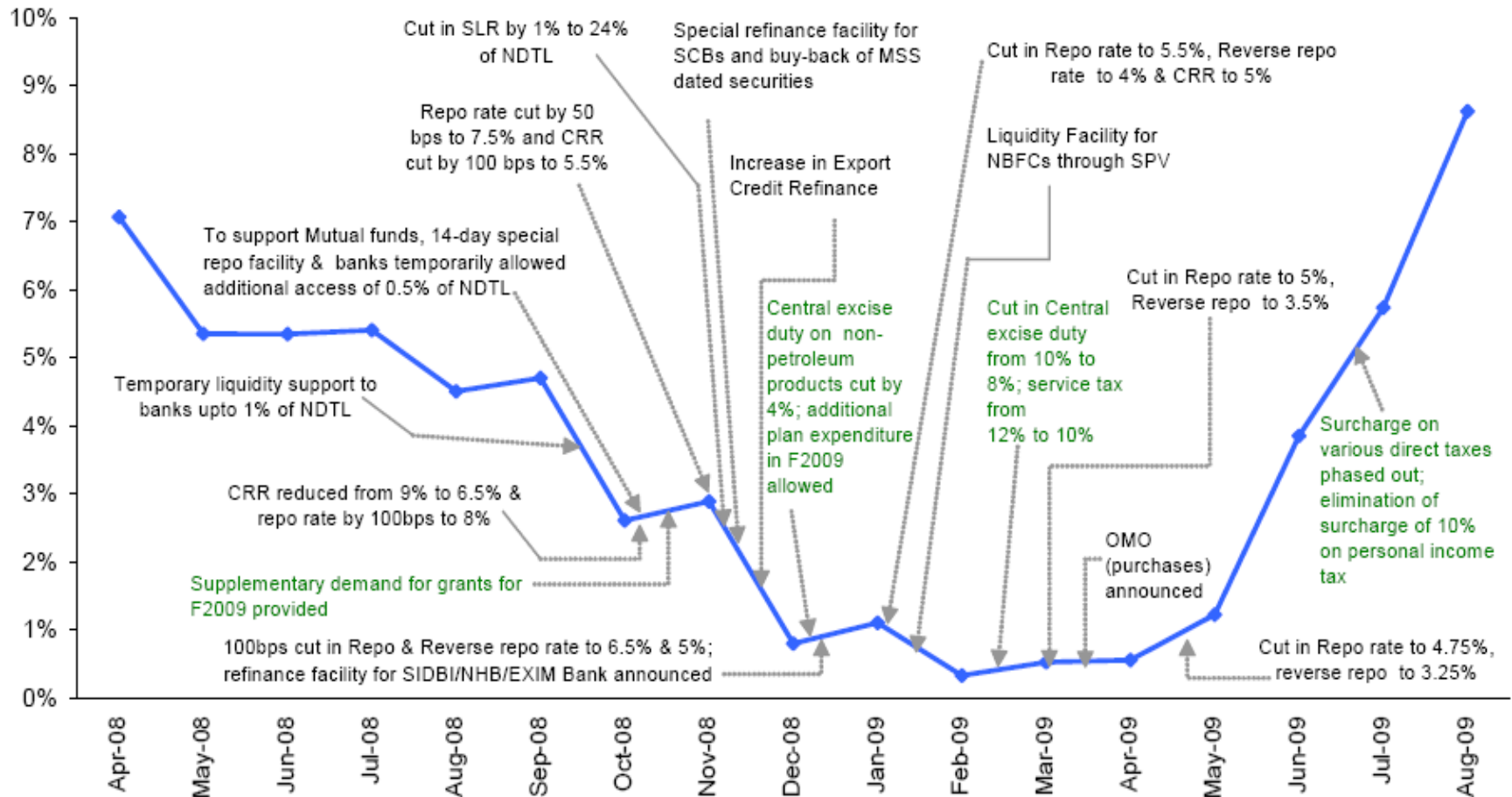


- Central government tax revenues continued to decline on a yoy basis.
- This is expected to pressure the government to withdraw the economic stimulus it had doled out in the previous year to jumpstart the economy

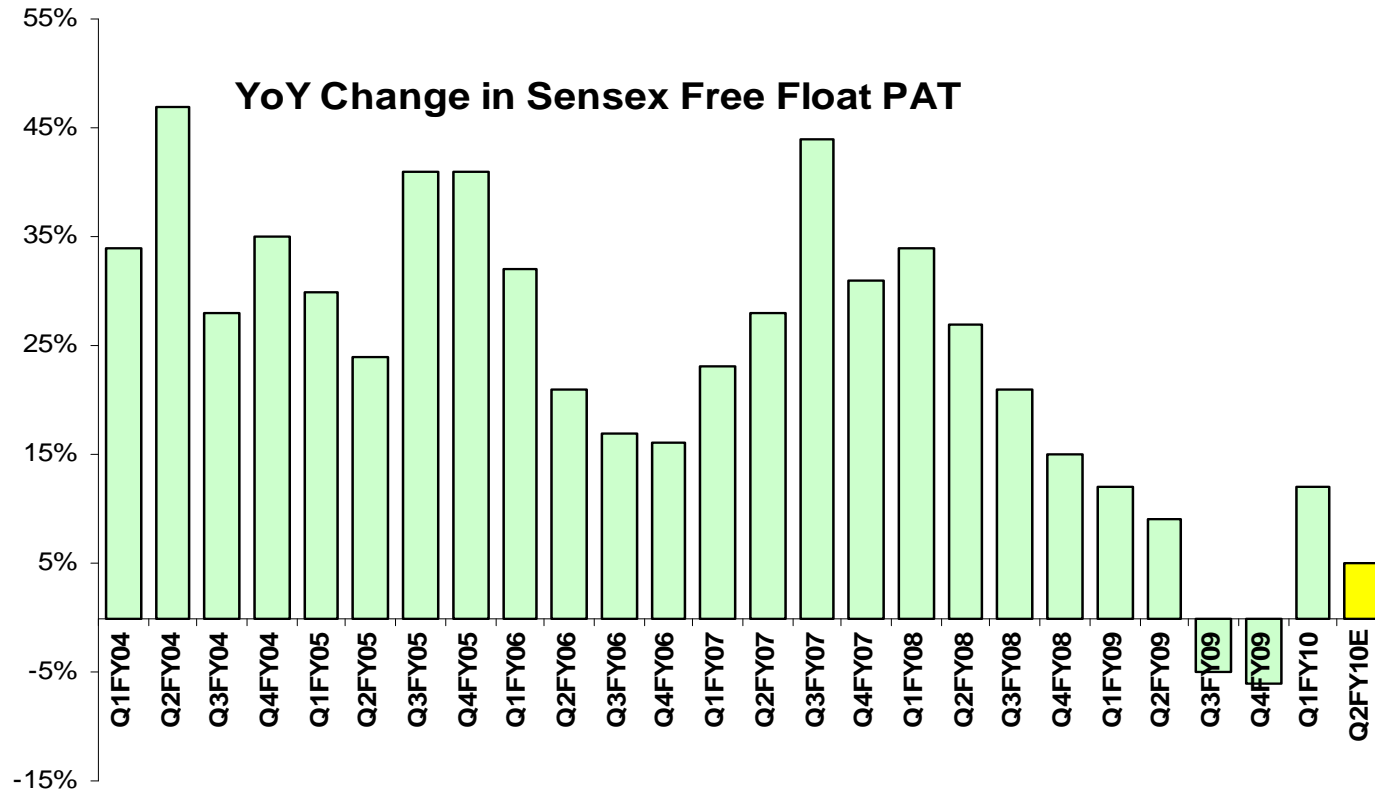


Stimulus Measures Announced During the Downturn

Industrial Production Growth (YoY%, 3MMA)



Domestic Earnings - Sept'09 Quarter Results

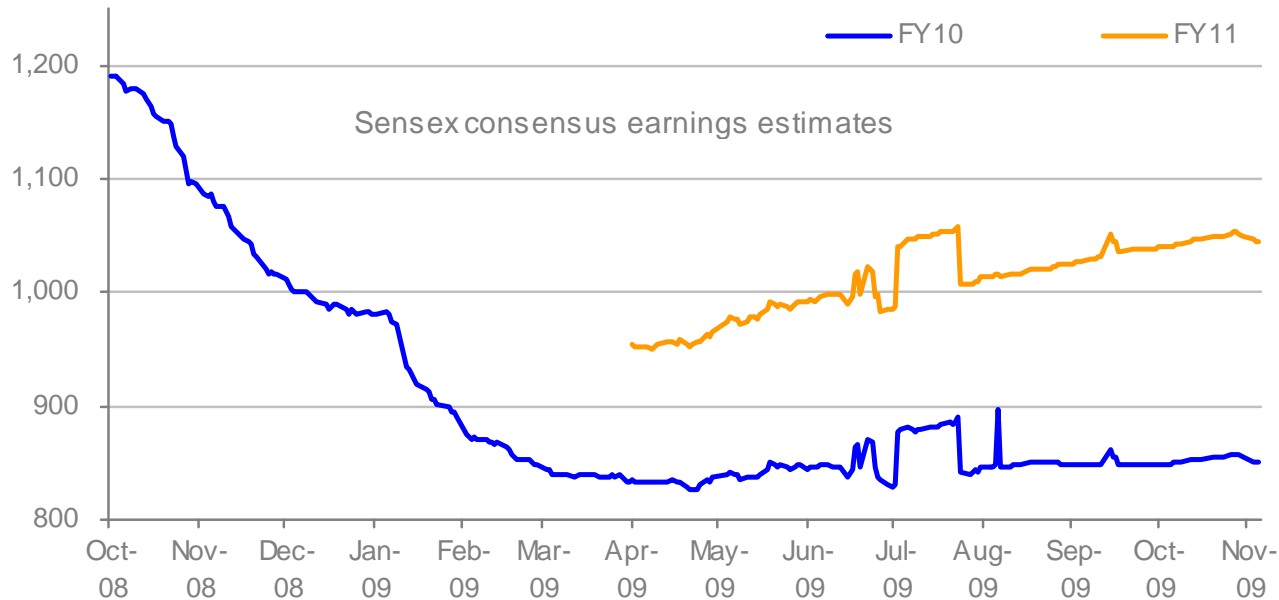


- Q2FY10 Sensex free float PAT grew 5% on a YoY basis. The growth is better than a 1% decline expected by market
- 10/14 sectors reported growth on a pre-exceptional basis, led by Oil & Gas (loss in 2QFY09), Pharma (129%) and Autos (59%). On the other hand, Real estate (-70%), Metals (-35%) and Telecom (-16%) reported YoY decline in profits



Domestic Earnings - Full Year Expectations

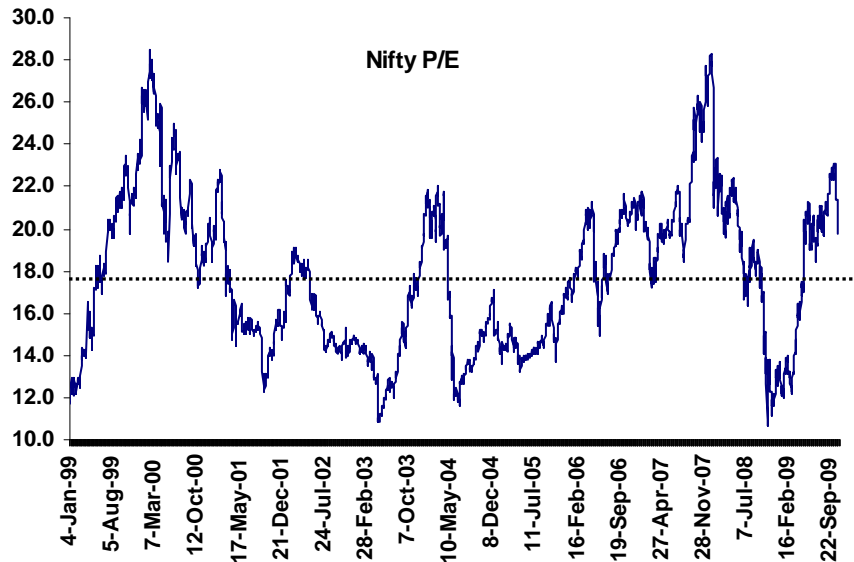
Sensex consensus earnings estimates



- FY10 and FY11 consensus Sensex EPS estimate saw a downgrade of about 0.8% this week
- Consensus now expects a 2% decline in FY10 Sensex earnings over FY09 and a 22.7% growth in FY11 Sensex EPS over FY10.

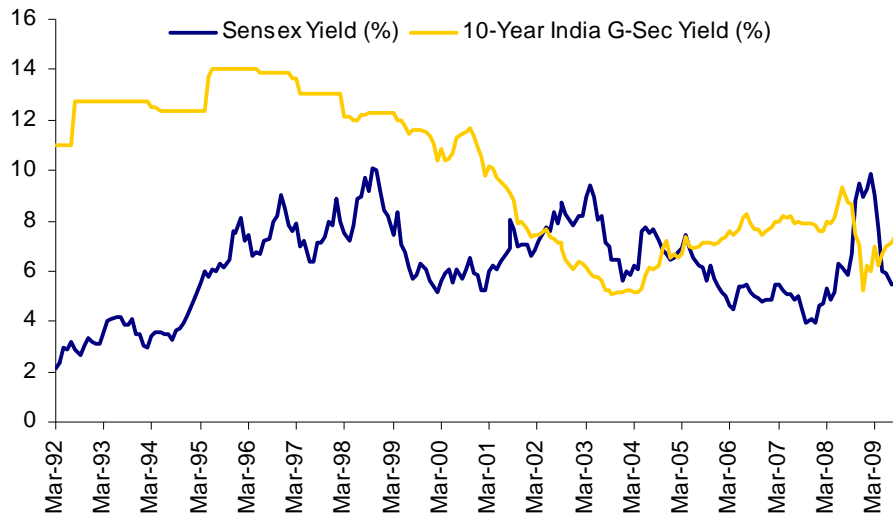


Valuation above long term averages



- Nifty is currently trading at 19.81x its trailing earnings, higher than the ten year average of 17.8x

- The Sensex earnings yield continues to remain lower than the benchmark 10 year yield, unlike the attractive equation earlier this year. The gap between Sensex earnings yield and bond yield has narrowed by 8 basis points over the previous month



- The valuation surge is not unique to India. The MSCI Emerging Market Index is also trading at approximately 21.36x trailing earnings



Looking Ahead...

- The macro environment continues to improve as is indicated by an improvement in leading indicators like IIP, to which corporate revenue growth is highly correlated
- On the flip side, due to strong economic growth, policy makers have now shifted their focus to an 'exit strategy'. This is also being thrust upon them due to deteriorating fiscal situation and commitment to adhere to fiscal targets as indicated in the medium term fiscal policy statement
- Disinvestment in PSU's appears to be one of the key policy responses of the government to address the fiscal deficit
- Current trends are consistent with a 6-6.5% GDP growth expectation, the upside surprise in industrial production is being offset by the likely weaker performance from the agriculture sector
- Credit growth, an important lead indicator, has not shown much growth so far possibly indicating a conservative approach by both lenders and borrowers
- Correlation between global markets remains very high and is a source of risk
- After this month's correction, we are now back in the comfort zone in terms of valuations, though still above average levels
- We maintain our stance that the recovery is now factored into earnings estimates and valuations and upside are likely to be led more by stock picking

Investment view

Short term

- The improvement in industrial activity is being partially offset by the weak monsoon; GDP growth likely to be 6-6.5% in FY10
- We expect earnings to be flat in in FY10 over FY09. The current consensus forecasts a healthy 22% in FY11 but we would be cautious about visibility of this estimate
- Markets are now finely priced with most measures trading above long term averages and a recovery is being priced in

Long term

- India will double in size, adding \$1trillion to GDP over the next 5-7 years
- Over the same period earnings should match nominal GDP growth @12-14% p.a. but will be back ended
- The elevated valuation measures might reduce the returns to below earnings growth.

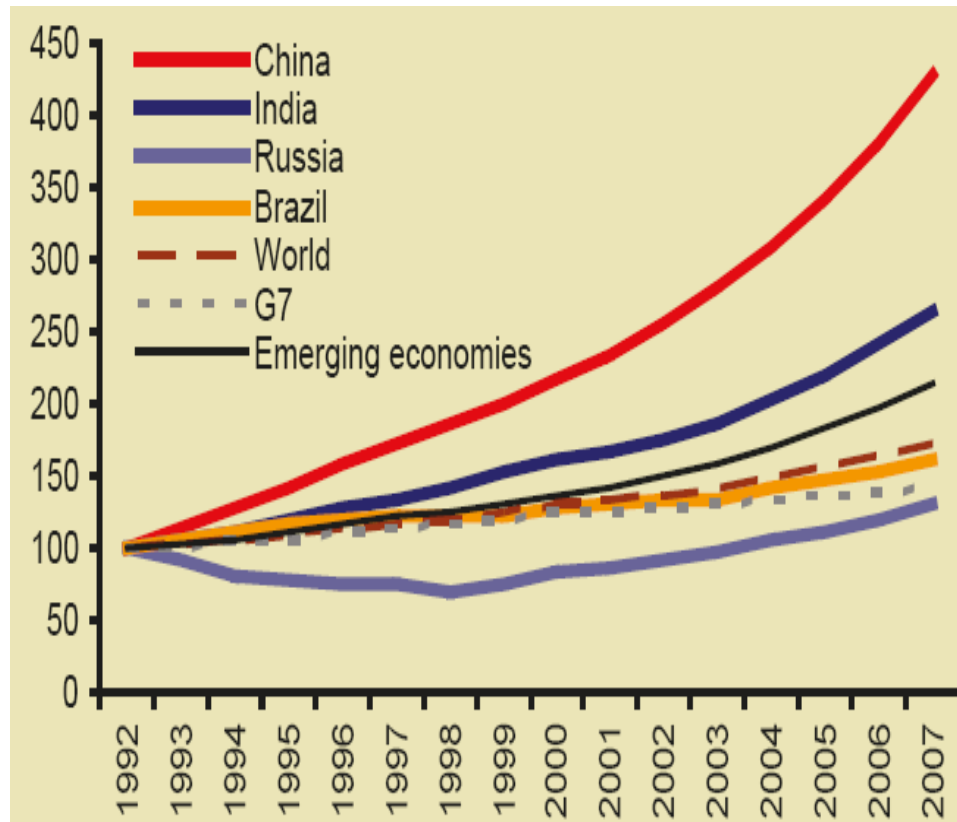
Strategy for investors

- The valuations are back in the comfort zone though priced above long term averages.
- Long term investors can continue with SIP

The Long Term Case For Indian Equities

India - Growth On The Fast Track

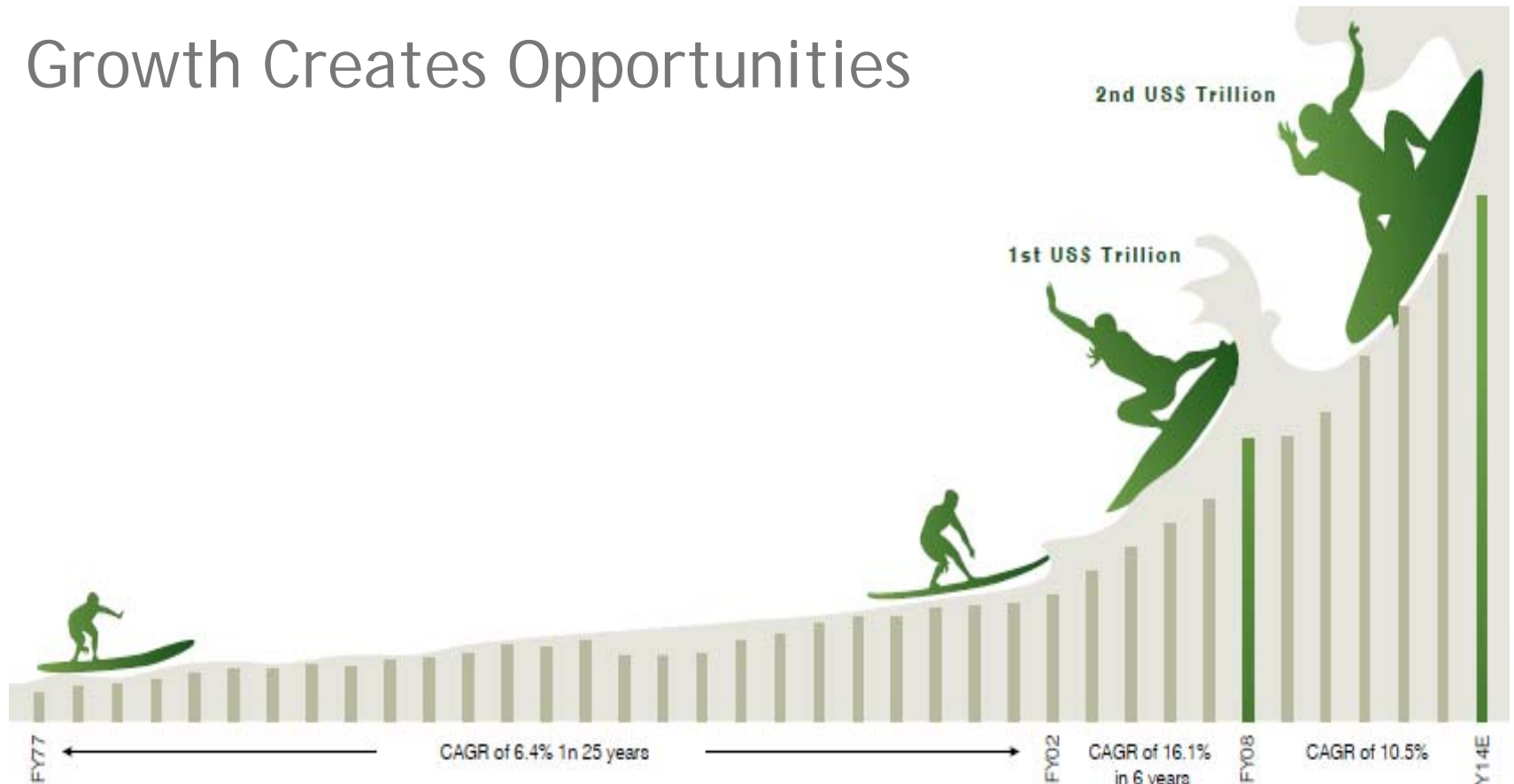
GDP growth rebased to 1992



- India's economy has been the among the fastest growing economies in the world driven by:
 - Increase in savings rate
 - Rising capital formation
 - Better demographics and
 - Rising consumption

Source: IMF, IIFL Research

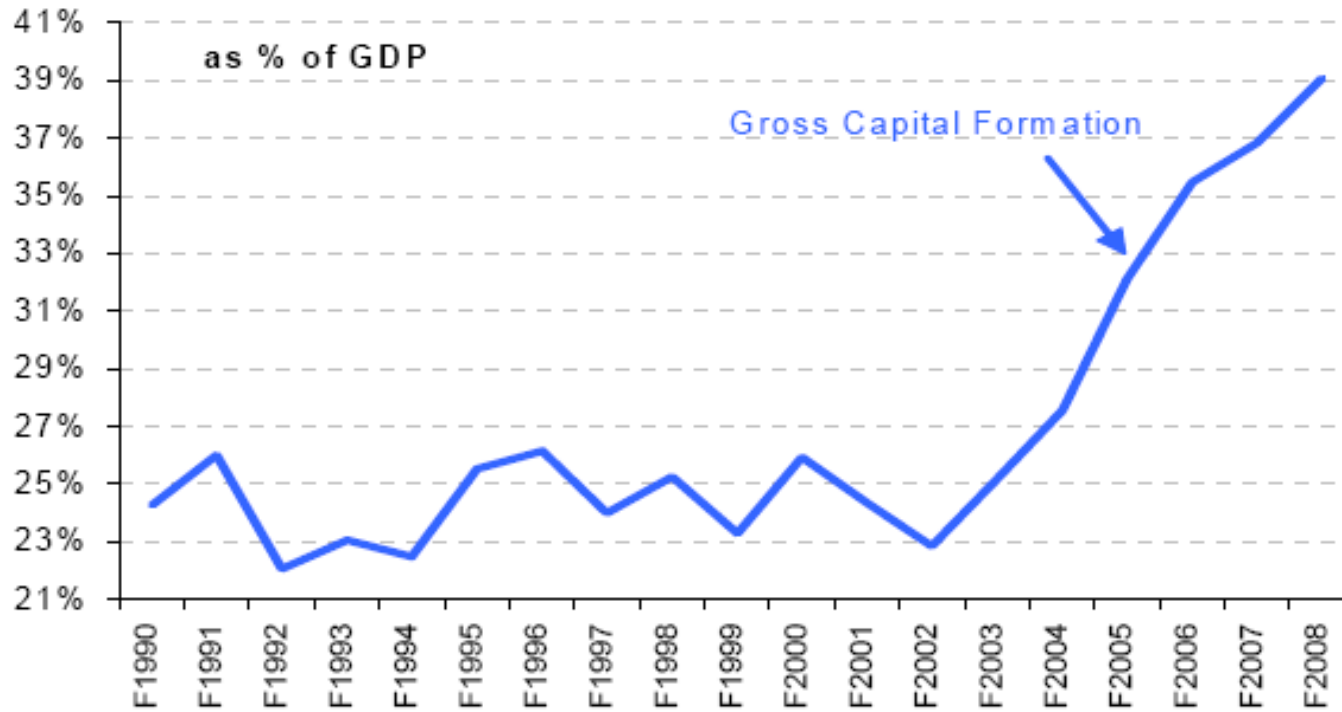
Growth Creates Opportunities



- India became a Trillion Dollar Economy (12th largest country by GDP in FY2008)
- The economy is expected to add another Trillion Dollars to annual output in 6 Years i.e. 2014
- That is likely to make India the 8'th largest economy in the world.
- This is a structural transformation driven by increasing investments, growing consumption and a young workforce
- For equity investors : an attractive investment opportunity

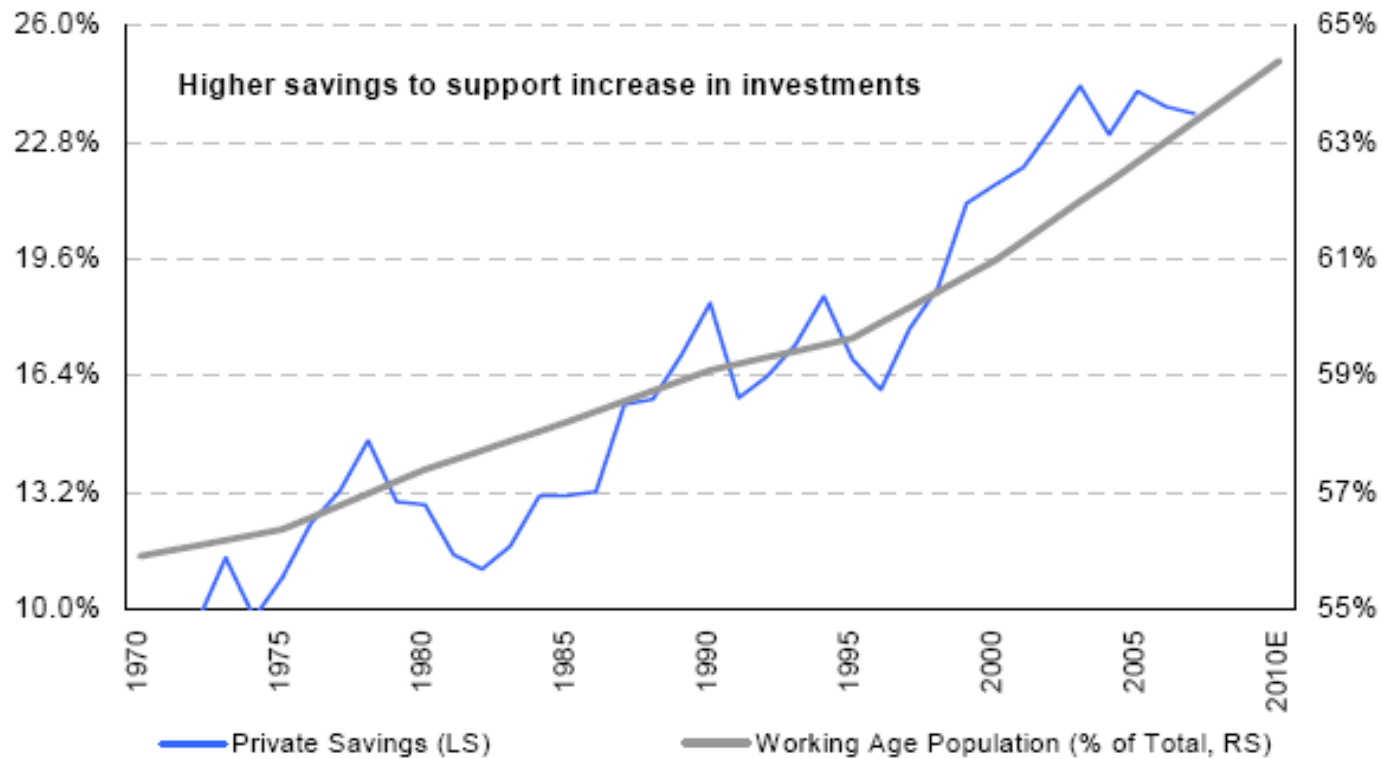


Growth Is Being Led By A Rise In Capital Formation...



Source: CSO, Morgan Stanley Research

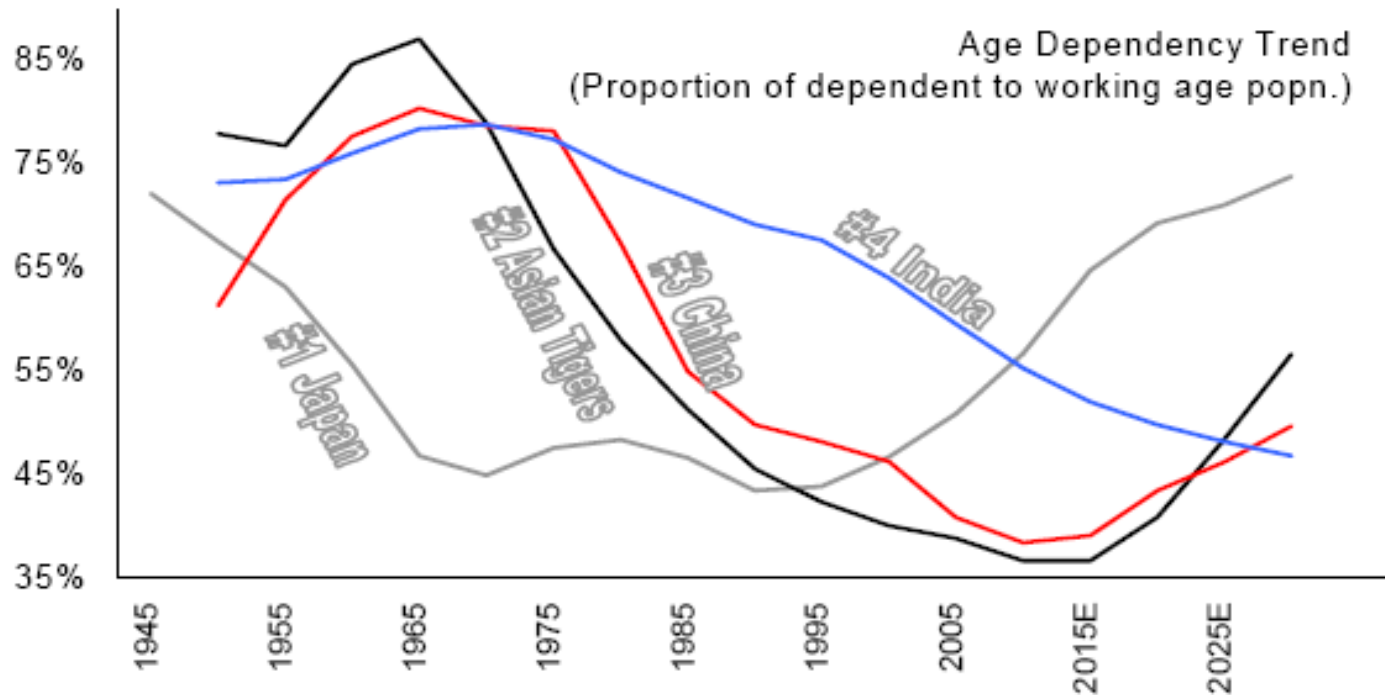
...Which Is Supported By A High Savings Rate



Source: CSO, UN, Morgan Stanley Research E= United Nations Research estimates

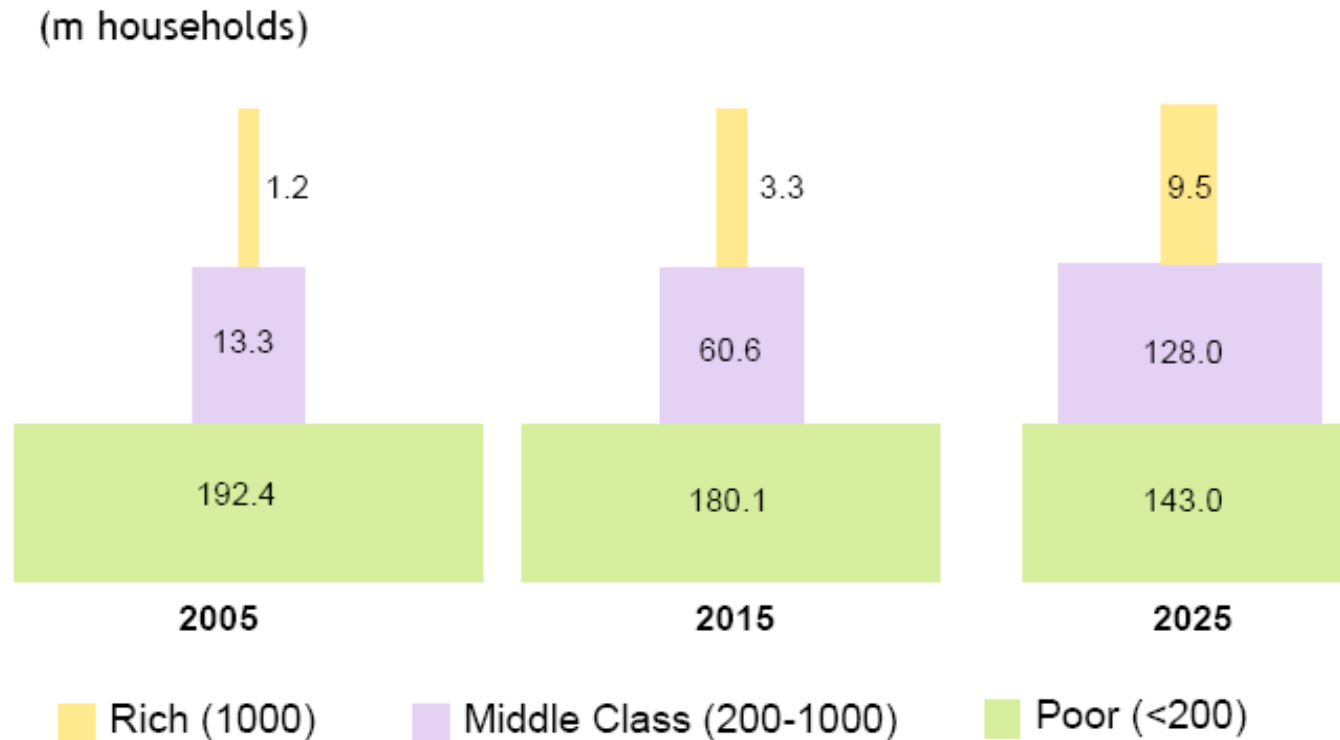


India Is Poised To Reap Rich Demographic Dividend In Years To Come



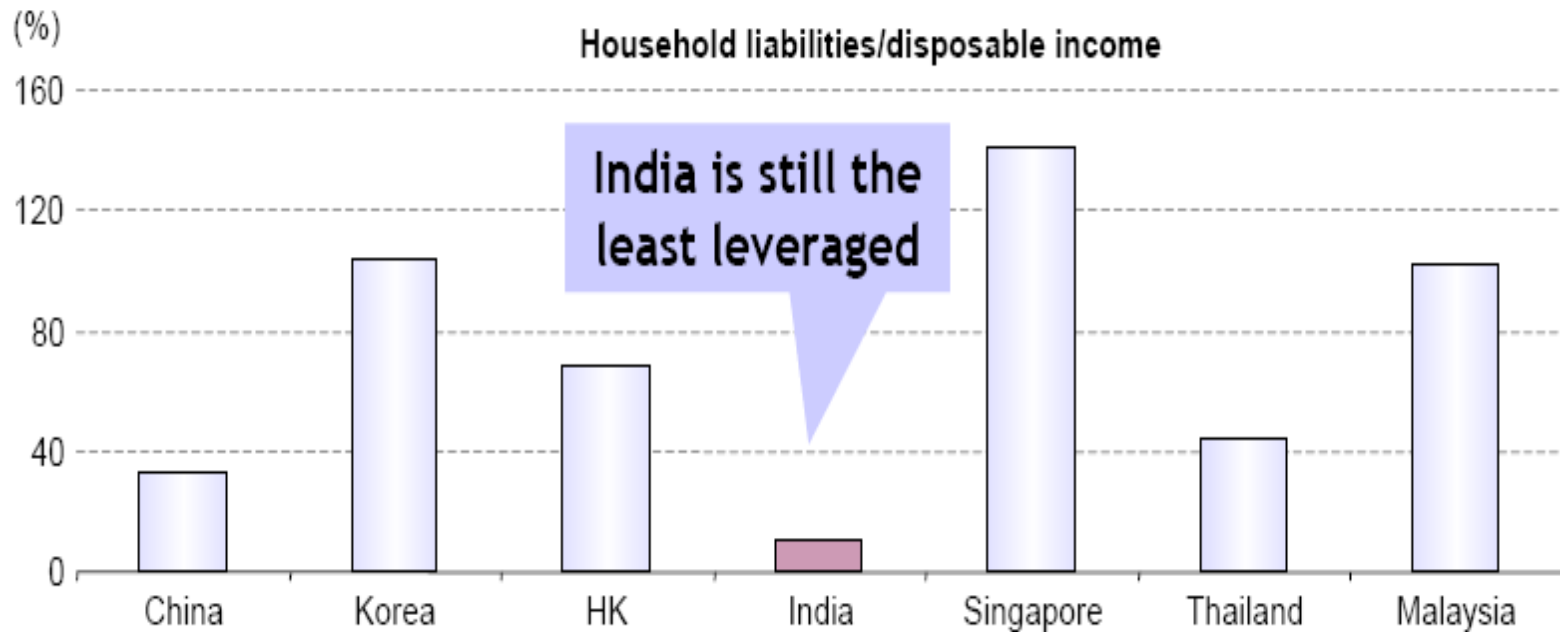
E= United Nations Research estimates Source: UN, Morgan Stanley Research

Income Imbalance To Correct Leading To Rise In Consumption



Source: IDFC SSKI

Indian Consumer Is Conservative; Consumption Largely Driven By Income Growth And Not Leverage



Source: IDFC SSKI

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MKTG/RoundupEquity/1009/CO014



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